

## Internal Revenue Service

## Department of the Treasury

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Date:

**July 30, 2002**

### LEGEND:

Distributing =

Controlled =

Holding =

Sub 1 =

Sub 2 =

LLC =

F Sub =

F Parent =

F Corp =

F Corp Sub =

Legal Counsel =

Business A =

Business B =

Country A =

Country B =

Country C =

Date A =

Date B =

a =

b =

c =

d =

e =

f =

g =

h =

i =

i =

k =

l =

m =

**Dear :**

This letter responds to your January 23, 2002 request for rulings on certain federal income tax consequences of a transaction, portions of which have already been completed. The information submitted in that letter and in subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer accompanied by a penalties of perjury statement executed by an appropriate party. Verification of these facts and representations may be required as a part of the audit process.

### **SUMMARY OF FACTS**

Distributing is a widely held, publicly traded Country A corporation with a single class of voting common stock. Distributing conducts Business A directly and through affiliated subsidiaries, and Business B through affiliated subsidiaries.

Holding is a domestic corporation that is wholly owned by Distributing. The assets of Holding consist of (i) all the outstanding stock of Controlled, (ii) a parcel of land, a portion of which is leased to Controlled for use in Controlled's business, and (iii) cash and short-term investments. Holding formerly owned all the issued and outstanding equity interest in LLC, a domestic limited liability company that was formerly Sub 1, a domestic corporation, had an interest as lessee in an office lease, and owned certain assets related to the leased office.

Controlled is a domestic corporation with a single class of voting common stock. Controlled is directly engaged in Business B and is wholly owned by Holding. Controlled has issued options to employees to acquire shares of its common stock. Even if all such options were exercised, Distributing would still control Controlled within the meaning of § 368(c) of the Internal Revenue Code ("Code") immediately prior to the Distribution (as defined below).

Sub 2 is a domestic corporation wholly owned by Distributing.

F Sub is a Country A corporation wholly owned by Distributing. F Sub is engaged in Business B.

F Corp is a Country B corporation and an indirect subsidiary of F Parent, a publicly traded Country C corporation. F Corp wholly owns F Corp Sub, a Country A corporation that is engaged in Business A. F Corp, F Parent, and F Corp Sub are unrelated to Distributing.

Financial information has been received indicating that Distributing and Controlled each is engaged in the active conduct of a trade or business within the meaning of § 355(b) of the Code.

Distributing and F Corp have entered into an agreement (the “Agreement”) to combine the Business A operations of F Corp Sub with those of Distributing (the “Combination”). However, Distributing and F Corp, for certain reasons, are unwilling to proceed with the Combination unless Distributing first divests itself of Controlled. Legal Counsel has documented certain regulatory constraints and concerns which further support the divestiture of Controlled prior to the Combination.

## **THE TRANSACTION**

To facilitate the Combination and avoid the regulatory constraints and concerns documented by Legal Counsel, Distributing and F Sub have agreed to undertake the following series of steps, some of which have already occurred (collectively, the “Transaction”):

### Completed Steps

(i) On Date A, Sub 1 was converted, under applicable state law, from a corporation into LLC, a limited liability company (the “Conversion”), following which it has been treated as a disregarded entity for federal income tax purposes under § 301.7701-3(b)(1)(ii) of the Procedure and Administration Regulations.

(ii) On Date B, Sub 2, a newly created subsidiary of Distributing, purchased all of Holding’s interest in LLC, as well as the office lease and related assets, for cash in an amount intended to equal the fair market value of the purchased assets (the “Purchase”). Holding’s interest in LLC represented approximately a% by value of Holding’s total assets.

(iii) On Date B, Distributing contributed \$b to Holding (the “Transfer”).

### Steps Not Yet Completed

(iv) Holding will merge into Controlled under applicable state law and Controlled

will be the surviving corporation (the “Holding-Controlled Merger”).

(v) F Corp will commence a tender offer (the “Tender Offer”) to purchase up to c shares of Distributing, or, if greater, a number of shares equal to d% of the outstanding shares of Distributing as of the record date for the Distribution. Based upon the currently outstanding shares and convertible debt of Distributing, c shares represents approximately e% of the shares of Distributing on a fully diluted basis (treating outstanding convertible bonds issued by Distributing as exercised) and approximately f% of the currently outstanding shares of Distributing. The Tender Offer will be commenced shortly after the record date and prior to the effective date of the Distribution.

(vi) The outstanding stock of Controlled will be reclassified through a reverse stock split so that there are an appropriate number of issued and outstanding shares for the Distribution (the “Reverse Split”).

(vii) Distributing will distribute all of the stock of Controlled to the Distributing shareholders on a pro rata basis (the “Distribution”). In addition, Distributing will make a cash distribution to its shareholders in the aggregate amount of g, which is \$h at an exchange rate of i to the dollar (the “Cash Distribution”). In the case of shareholders who would otherwise be entitled to receive fractional shares of Controlled stock in the Distribution, the fractional shares will be aggregated and sold on the open market by an agent, with the proceeds being distributed to such shareholders on a pro rata basis in lieu of the fractional shares. It is anticipated that Controlled will be publicly traded following the Distribution, and Controlled has applied to have its common stock quoted and traded on the Nasdaq National Market.

(viii) Following the Distribution, F Corp will acquire additional newly issued Distributing shares from Distributing for cash. The number of newly acquired shares, together with the Distributing shares acquired by F Corp in the Tender Offer in step (v) above, and the Distributing shares to be acquired by F Corp in the Distributing-F Corp Sub Merger (as defined in step (ix) below), will equal j% of the outstanding shares of Distributing stock.

(ix) F Corp Sub will merge into Distributing and Distributing will be the surviving corporation (the “Distributing-F Corp Sub Merger”). In the Distributing-F Corp Sub Merger, F Corp will exchange its F Corp Sub stock for k Distributing shares, representing an approximately l% interest (m% on a fully diluted basis) in Distributing based upon the number of Distributing shares currently outstanding. F Corp will also exchange convertible bonds of F Corp Sub for convertible bonds of Distributing. Under Country A law, Distributing shareholders who vote against the Distributing-F Corp Sub Merger and exercise dissenters’ rights can require Distributing to repurchase their Distributing shares.

Following the Distribution, Controlled may adopt a shareholder rights plan (the

“Rights Plan”) under which holders of Controlled common stock will receive rights to acquire additional shares of Controlled stock upon the occurrence of certain triggering events.

Distributing has entered into an agreement to sell its entire interest in F Sub to an unrelated party (the “F Sub Sale”). The F Sub Sale is expected to be completed shortly after the Distribution. Following the F Sub Sale and the Distribution, Distributing and its affiliated subsidiaries will no longer be engaged directly or indirectly in Business B.

Controlled and LLC were parties to a cross-license agreement relating to certain technologies. The cross-license agreement has been terminated. Controlled and F Sub are parties to a distribution agreement and a license agreement (the “Distribution and License Agreements”), each of which is expected to continue following the Distribution and the F Sub Sale. Controlled formerly subleased office space from LLC. The sublease has been terminated.

Distributing and Controlled have entered into a Separation and Distribution Agreement that sets forth the parties’ agreements regarding the Distribution, and requires each of Distributing and Controlled to indemnify the other party for certain liabilities relating to the indemnifying party’s business. In addition, Controlled will be required to indemnify Distributing in the event that, within 15 months following the Distribution, certain events involving the stock or assets of Controlled occur and Distributing’s Country A tax liability in connection with the Distribution is greater than anticipated. The indemnity arrangements between Distributing and Controlled will hereinafter be referred to as the “Indemnity”.

On or prior to the date of the Distribution, Controlled and LLC will enter into a tax sharing agreement (the “Tax Sharing Agreement”). In addition, Controlled and LLC have entered into a transition services agreement (the “Transition Services Agreement”) pursuant to which Controlled will provide LLC, for a brief period following the date of the sale of LLC to Sub 2 (subject to early termination at the option of LLC) with: (i) administrative services with respect to LLC employee benefit plans, (ii) finance and accounting services, (iii) human resource services, including, but not limited to, access to a human resource database and upgrades and maintenance of information storage facilities, and (iv) other services related to general workplace management.

## **REPRESENTATIONS**

The taxpayer has made the following representations concerning the Transaction:

(a) Any indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

(b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.

(d) The five years of financial information submitted on behalf of Controlled is representative of Controlled's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.

(e) Following the Transaction, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees.

(f) The Distribution is being carried out for the corporate business purposes of facilitating the Combination and avoiding certain regulatory constraints and concerns. The Distribution is motivated, in whole or substantial part, by these corporate and other business reasons.

(g) The management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular shareholder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the Transaction.

(h) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Revenue Procedure 96-30.

(i) Except for the Distributing-F Corp Sub Merger and the Holding-Controlled Merger, there is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Transaction, except in the ordinary course of business.

(j) There will be no intercorporate debt between Distributing and Controlled at the time of and subsequent to the Distribution, with the possible exception of trade payables between Controlled and Distributing or their subsidiaries incurred in the ordinary course of business and obligations arising under the Tax Sharing Agreement, the Transition Services Agreement, and the Distribution and License Agreements.

(k) Payments made in connection with any continuing transaction between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(l) No two parties to the Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(m) The payment of cash in lieu of fractional shares of Controlled is solely for the purpose of avoiding the expense and inconvenience of issuing fractional shares and does not represent separately bargained for consideration. The method used for handling fractional share interests is designed to limit the amount of cash received by any one shareholder to less than the value of one full share of Controlled stock. The total amount of cash paid in lieu of fractional shares will not exceed one percent of the fair market value of Controlled stock distributed to Distributing's shareholders in the Transaction.

(n) Immediately after the Distribution, the gross assets of the businesses actively conducted (as defined in § 355(b)) by each of Distributing and Controlled will have a fair market value equal to at least five percent of the total fair market value of the corporation's gross assets.

(o) Neither Distributing nor Controlled was a United States real property holding corporation (as defined in § 897(c)(2)) at any time during the 5-year period ending on the date of the Distribution, and neither Distributing nor Controlled will be a United States real property holding corporation immediately after the Distribution. To the best of Distributing's knowledge, there are currently no foreign persons owning 5 percent or more of the stock of Distributing. Following the Transaction, F Corp will be the only foreign person owning 5 percent or more of the stock of Distributing.

(p) Distributing is not and will not be a passive foreign investment corporation (as defined in § 1296(a)) or a controlled foreign corporation (as defined in § 957) either before or after the Distribution.

## **RULINGS**

Based solely on the information submitted and on the representations set forth above, we rule as follows:

(1) Except for the Cash Distribution, no gain or loss will be recognized by (and no amount will otherwise be included in the income of) Distributing's shareholders on the Distribution (§ 355(a)(1) and 356). The Cash Distribution will be treated as a distribution of property to which § 301 applies (§ 356(b) and 1.356-2(a)).

(2) The aggregate basis of the Distributing and Controlled stock in the hands of each Distributing shareholder after the Distribution will equal the basis of the Distributing stock held by the shareholder immediately before the Distribution, decreased by the amount of cash received by such shareholder in the Cash Distribution, and increased by the amount of such cash that is treated as a dividend to



such shareholder (§§ 358(a)(1) and 358(c)). The aggregate stock basis will be allocated between the Distributing and Controlled stock in proportion to the fair market value of each immediately after the Distribution in accordance with § 1.358-2(a)(2) (§ 358(b)(2)).

(3) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing stock with respect to which it was distributed, provided that the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(4) The receipt of cash in lieu of fractional shares in Controlled will be treated as if the fractional shares were distributed as part of the Distribution and then redeemed by Controlled. These cash payments will be treated as having been received as distributions in full payment in exchange for the shares considered redeemed, as provided in § 302(a) (Rev. Rul. 66-365, 1966-2 C.B. 116 and Rev. Proc. 77-41, 1977-2 C.B. 574).

(5) Earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h), § 1.312-10(b), and § 1.1502-33.

### **CAVEATS**

No opinion is expressed about the federal tax treatment of the Transaction under other provisions of the Code or regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Transaction that are not specifically covered by the above rulings. In addition, no opinion is expressed regarding the federal income tax consequences of: (i) the Conversion, (ii) the Purchase, (iii) the Transfer, (iv) the Reverse Split, (v) the Distributing-F Corp Sub Merger, (vi) the Rights Plan (if adopted), (vii) the F Sub Sale, (viii) the Holding-Controlled Merger, and (ix) any payments made under the Distribution and License Agreements, the Tax Sharing Agreement, the Indemnity, and the Transition Services Agreement.

### **PROCEDURAL STATEMENTS**

This ruling letter is directed only to the taxpayer(s) who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Each taxpayer affected by the Transaction should attach a copy of this ruling letter to its, his, or her federal tax return for the taxable year in which the Transaction is completed.

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In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

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Sean P. Duffley  
Assistant to the Chief, Branch 4  
Office of Associate Chief Counsel  
(Corporate)